IN THE

Supreme Court of the United States

OCTOBER TERM 1944.

No. 317

J. STERLING ROCKEFELLER,

Petitioner,

vs.

JOSEPH D. NUNAN, Commissioner of Internal Revenue for the Second District of New York,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

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vs.

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Respondent.

BRIEF IN SUPPORT OF PETITION.

Opinions Below.

The opinion of the Tax Court of the United States has been reported only in memorandum form but is set forth in full in the transcript (R. 36 to 37). The opinion of the United States Circuit Court of Appeals for the Second Circuit has been reported officially in 142 Federal Reporter 2d Series pages 354 to 356 and is set forth in full in the transcript (R. 185 to 188).

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925. The case arises under an internal revenue law.

Statement of the Case.

For a statement of the case reference is made to the summary statement contained in the petition for writ of certiorari filed herein on pages 2 to 5.

Specification of Errors.

The Circuit Court of Appeals for the Second Circuit in its decision herein erred:

1. In refusing to determine that the petitioner ascertained as worthless during the calendar year 1937 the $78,000 face amount of Garrison Fire Detecting System, Inc. Secured Debenture Bonds which cost the petitioner $76,900, and in refusing to allow as a deduction from petitioner's gross income for the year 1937 said sum of $76,900 as a bad debt ascertained and charged off the petitioner's books as such in 1937.

2. In determining that the petitioner did not prove that the hope which petitioner entertained throughout 1936 of some salvage from his investment in the Secured Debentures was extinguished in 1937, in view of the petitioner's uncontradicted testimony that as a result of the sale of the patent interests by the Trustee at a price which did not permit any payment to the bondholders, the petitioner determined his debentures were worthless and valueless (R. 53).

3. In determining that all the Tax Court decided was that petitioner had not proved that he "ascertained" the Secured Debentures to have become "worthless" in 1937, in view of the Tax Court's statement that the Commissioner had determined, in effect, that the petitioner had ascertained such worthlessness in 1936 (R. 37) although the Commissioner had never, according to the proof, made such a determination (R. 11).

4. In determining that the petitioner reported his gross income for 1936 at $103,477.89 against which he claimed deductions aggregating $53,322.02 for the reason that the Circuit Court has stated that no year other than 1937 has any bearing in the matter and accordingly petitioner's individual income tax return for the calendar year 1936 was inadmissible, irrelevant and immaterial just as much as his similar return for any year other than 1937 would have been and that no charge or finding had been made of anything but good faith on petitioner's part.

5. In failing to admit in evidence the 1937 individual federal income tax return of Earl H. Johnson and the offer of testimony in connection therewith.

6. In finding a deficiency of $32,733.96 for the year 1937 in lieu of the determination that there is no income tax due from petitioner for the year in controversy.

ARGUMENT.

POINT I.

The petitioner ascertained during the calendar year 1937 that his Secured Debentures were worthless and in 1937 charged off the cost thereof to him.

The evidence is uncontradicted that the petitioner decided in 1937 as a result of the Bankruptcy sale in that year that the Secured Debentures were worthless and that the petitioner's accountant in 1937, at the direction of the petitioner, made the proper entry charging off and showing the worthlessness in 1937 of the Secured Debentures owned by the petitioner to the extent of an original entry of $77,000 reduced by stipulation to $76,900. (Record 29, 53, 60 to 62, 80).

In the case of *Rosenthal* v. *Commissioner*, 124 Fed. 2d, 474, 476 (C. C. A. 2d), the use of the subjective test in

determining ascertainment of worthlessness was stated in the following language:

> "In *Curry* v. *Commissioner*, 2 Cir., 117 F. 2d 307, 309, 310, we held, however, that the 'subjective test' as we called it, was the right one; that is, that the proper year was that in which the taxpayer did 'ascertain' the fact, no matter how much earlier a reasonably prudent person would have done so. *Moore* v. *Commissioner*, 2 Cir., 101 F. 2d 704, and *Jones* v. *Commissioner*, 7 Cir., 38 F. 2d 550, suggests the same doctrine, though they can scarcely be said to decide it; *Sabath* v. *Commissioner*, 7 Cir., 100 F. 2d 569, is the other way. The cases are not in accord, but with deference we can find no ground for importing any 'objective test' into the section. The language does not intimate anything of the sort, the contrast with §23 (e) and (f) suggests the opposite, and there is no disclosed or probable purpose which the natural meaning of the words will thwart. If it be objected that the 'subjective test' offers opportunity for evasion, we answer, first, that the taxpayer has the burden of proving a negative—i. e., he must show that he did not 'ascertain' the debt to have been 'worthless' before the year in question—second, that the fact that a prudent person would have 'ascertained' that fact earlier is always evidence that the taxpayer did so himself, and third, that if these two considerations do not adequately protect the Treasury, the responsibility for its better protection rests with Congress. We hold therefore that a taxpayer is not charged with the duty of 'ascertaining' the 'worthlessness' of a 'bad debt' at any time before he actually does so."

The Tax Court in its opinion in the instant cause had gone much further than was necessary under the principle of subjective test set forth above and had stated that it was the petitioner's burden to show erroneous the Commissioner's determination, in effect, that petitioner did so ascertain the worthlessness in 1936, and the Tax Court further reached the conclusion that the Secured Debentures were in fact worthless in 1936.

The Circuit Court recedes from the dilemma created by the decision of the Tax Court by ruling in effect that the

petitioner really did not ascertain the Secured Debentures to be worthless in 1936 and by his uncontradicted testimony as well as by evidence that he loaned money in 1936 to one of the licensees of the Delaware corporation, showed that he still retained at the end of 1936 hope that something might be realized from the sale of the patent interests which were the security for the Debentures. (See *Helvering* v. *Hammel*, 311 U. S. 504).

Using this face-about, the Circuit Court then strives for the conclusion that, because the patent interests were sold in 1937 for $100 subject, however, to the lien of the Secured Debentures, the petitioner's position is less plausible and that while the remnant of value may or may not have continued throughout 1937, there is no way to tell whether it did or not.

The above conclusion is in the face of the uncontradicted testimony of petitioner that, upon the sale by the Trustee in Bankruptcy of the patent interests, the taxpayer lost all hope of ever receiving anything on his Secured Debentures.

The petitioner after his experience of years in investing funds in the Delaware corporation and its licensees refused to put in any more money but allowed the patent interests to be sold. This very act, it is respectfully submitted, is further positive evidence of his ascertainment in 1937 of the worthlessness of the Secured Debentures.

The similarity is striking between the testimony of the petitioner herein and of the petitioner in the *Rosenthal* case, *supra*, after reference back to the then Board of Tax Appeals (not reported officially, Docket 99950, February 7, 1942). The general tenor of Rosenthal's testimony was that he did not ascertain the debt in question to have been worthless prior to 1936 but did so ascertain it as worthless in that year. He stated that he did not have any doubt in the years prior to 1936 that he would ultimately collect all or at least a substantial part of this indebtedness.

The Member also rendered the following opinion:

> "It goes without saying that this portion of the record furnishes, if believed, the most direct ap-

> proach to petitioner's state of mind, the question described in *Rosenthal* v. *Commissioner* as 'the only relevant fact.' While there is other testimony tending to qualify this statement or detract from its reliability, we are not willing to characterize it as deliberately false, as would be necessary were we to come to the contrary conclusion. * * *'''

There is no claim of lack of good faith on the part of the petitioner nor is there any other testimony tending to qualify or detract from the petitioner's uncontradicted testimony as to his ascertainment in 1937 of the worthlessness of the Secured Debentures. By the same token the 1936 federal individual income tax return of the petitioner is clearly irrelevant for the reasons already stated in Assignment of Error No. 4.

The findings of the Tax Court disclose the entire transaction and pertinent facts found in connection therewith are accordingly reviewable by the Circuit Court of Appeals and the decision of the Circuit Court on such points is reviewable in this Honorable Court. *Helvering* v. *Price*, 309 U. S. 409, 412.

The Circuit Court of Appeals for the Second Circuit admits that the cases are not in accord in the various Circuits but has, up until the instant cause, affirmed its belief in the principle which is enunciated in the Rosenthal decision. (*Mayer Tank Mfg. Co.* v. *Commissioner*, 136 Fed. 2d 588 (C. C. A. 2d); *Harris* v. *Commissioner*, 140 Fed. 2d 809 (C. C. A. 2nd, decided February 9, 1944). See also *San Joaquin Brick Co.* v. *Commissioner*, 130 Fed. 2d, 220 (C. C. A. 9th); *Matter of Huitt* v. *Mealey*, 292 N. Y. 52).

In view of the apparent conflict among the decisions of the various Circuit Courts of Appeals, and as this principle appears to be one which this Honorable Court has not passed on, so far as we have been able to ascertain, it is respectfully requested that the decision of the Circuit Court of Appeals in the instant case should be reviewed by this Honorable Court.

POINT II.

The Circuit Court of Appeals erred in upholding the refusal of the Tax Court to admit in evidence a certain statement attached to the 1937 Federal Income Tax Return of Earl H. Johnson, an owner of similar Secured Debenture Bonds, and the offer of testimony in connection therewith.

At the trial of this cause in the then Board of Tax Appeals, there was offered in evidence on behalf of the taxpayer a schedule attached to the individual federal income tax return for the taxable year 1937 of Earl H. Johnson, who was the holder of $10,000 of Secured Debenture Bonds of the Delaware corporation of the same series as those owned by the petitioner (R. 65). The exhibits and testimony offered would have shown that Earl H. Johnson claimed to have ascertained his Bonds to be worthless in the taxable year 1937 and had charged them off within that taxable year, and that after a review by the Technical Staff, the Commissioner of Internal Revenue, respondent herein, allowed Johnson's deduction in the year 1937 of the cost to Johnson of said Bonds. The information contained in the schedule attached to his tax return (R. 66) shows that all the substantial facts were before the Commissioner and that the Commissioner's decision thereon is highly important to demonstrate that the Commissioner had previously examined the matter and had found that the calendar year 1937 was the year in which the Debentures were reasonably ascertained to have become worthless.

It is respectfully submitted that the offer of the above testimony and evidence was relevant and material on the grounds above stated and that it was error to refuse this offer at the trial. Furthermore, it appears to be a case of first impression as this question has not, in so far as we have been able to find, been settled by this Court.

Respectfully submitted,

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APPENDIX.

Statute and Regulations Involved.

Revenue Act of 1936, c. 690, 49 Stat. 1648:

Section 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

* * * * * *

(k) *Bad debts.*—Debts ascertained to be worthless and charged off within the taxable year.

Regulations 94:

Article 23 (k)-1.

"* * * * * *

"If all the surrounding and attending circumstances indicate that a bad debt is worthless, either wholly or in part, the amount which is worthless and charged off or written down to a nominal amount on the books of the taxpayer shall be allowed as a deduction in computing net income. * * * In determining whether a debt is worthless in whole or in part the Commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor. * * *

"Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. Bankruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt. Actual determination of worthlessness in bankruptcy cases is sometimes possible before and at other times only

when a settlement in bankruptcy shall have been had. Where a taxpayer ascertained a debt to be worthless and charged it off in one year, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year, confirming the conclusion that the debt is worthless, will not authorize shifting the deduction to such later year.

* * * * * *

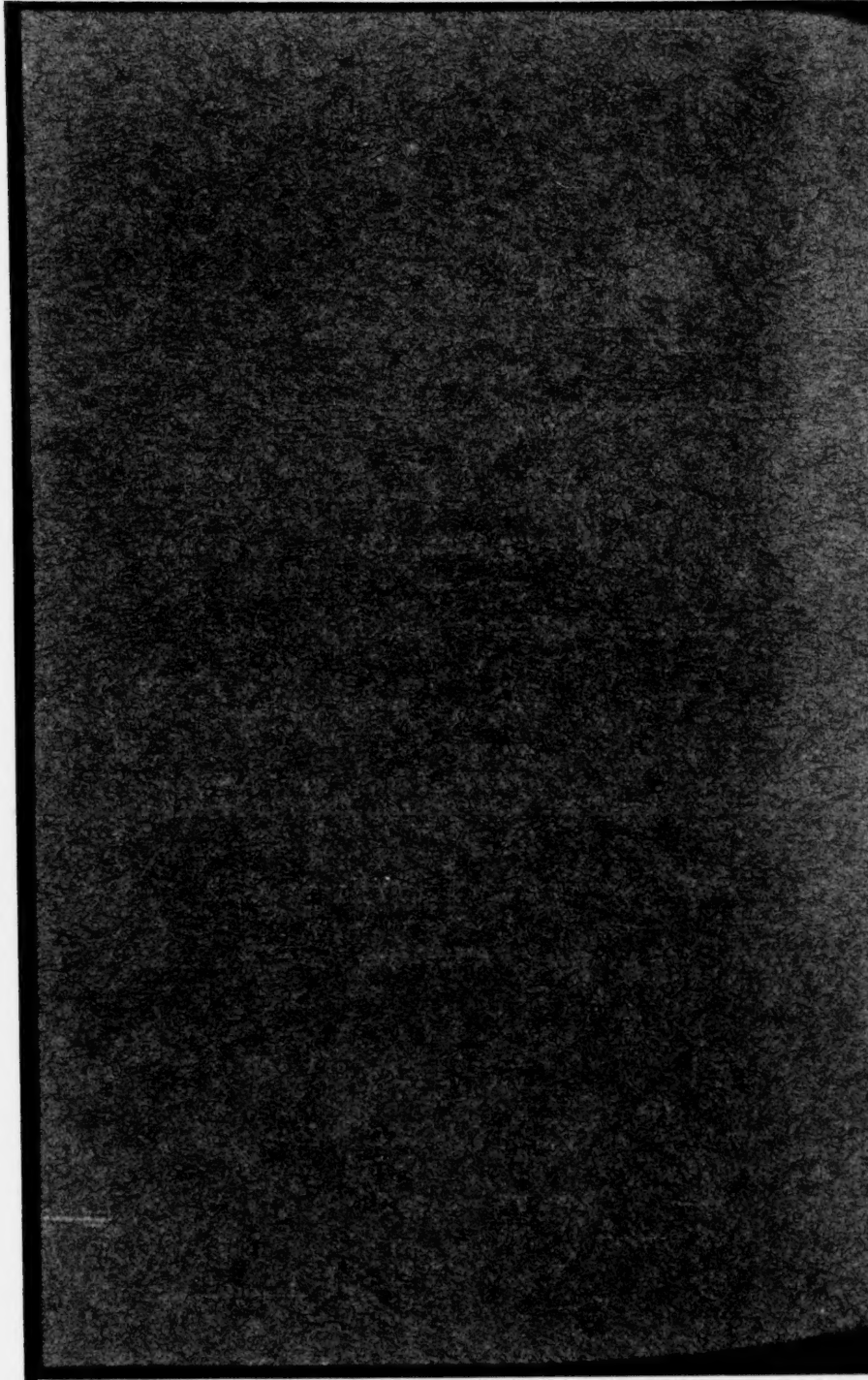
"Article 23 (k)-2. *Examples of bad debts.*— * * * Only the difference between the amount received in distribution of the assets of a bankrupt and the amount of the claim may be deducted as a bad debt. * * *"

"Article 23 (k)-3. *Uncollectible deficiency upon sale of mortgaged or pledged property.*—If mortgaged or pledged property is lawfully sold (whether to the creditor or another purchaser) for less than the amount of the debt, and the mortgagee or pledgee ascertains that the portion of the indebtedness remaining unsatisfied after such sale is wholly or partially uncollectible, and charges it off, he may deduct such amount (to the extent that it constitutes capital or represents an item the income from which has been returned by him) as a bad debt for the taxable year in which it is ascertained to be wholly or partially worthless and charged off. * * *

"* * * * * *"

"Article 23 (k)-4. *Worthless bonds and similar obligations.* — Bonds, if ascertained to be worthless may be treated as bad debts to the amount actually paid for them. Bonds of an insolvent corporation secured only by a mortgage from which on foreclosure nothing is realized for the bondholders are regarded as ascertained to be worthless not later than the year of the foreclosure sale, and no deduction for a bad debt is allowable in computing a bondholder's income for a subsequent year.

"A taxpayer (other than a dealer in securities) possessing debts evidenced by bonds or other similar obligations can not deduct from gross income any amount merely on account of market fluctuation. If a taxpayer ascertains, however, that due, for instance, to the financial condition of the debtor or conditions other than market fluctuation, he will recover upon maturity none or only a part of the debt evidenced by the bonds or other similar obligations and so demonstrates to the satisfaction of the Commissioner, he may deduct in computing net income the uncollectible part of the debt evidenced by the bonds or other similar obligations."



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COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The Tax Court entered memorandum findings of fact and an opinion which are not reported but appear at R. 30–37. The opinion of the Circuit Court of Appeals (R. 185–187) is reported at 142 F (2d) 354.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered May 6, 1944 (R. 192). The petition for a writ of certiorari was filed August 3, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Tax Court and the Circuit Court of Appeals for the Second Circuit have erred in determining that certain secured debentures issued by Garrison Fire Detecting System, Inc., a Delaware corporation, were not ascertained by the taxpayer to be worthless in 1937, the tax year for which the taxpayer claims a bad debt deduction under Section 23 (k) of the Revenue Act of 1936.

STATUTE INVOLVED

The applicable statute is Section 23 (k) of the Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (k) *Bad Debts.*—Debts ascertained to be worthless and charged off within the taxable year * * *
>
> * * * * *

STATEMENT

The facts as found by the Tax Court (R. 30–35) may be summarized as follows:

Early in 1931 the taxpayer purchased $74,000 face amount of debentures of the Garrison Fire Detecting System, Inc., a Delaware corporation, at a cost of $74,000. The corporation, organized in 1925 for the development, manufacture, and sale of automatic fire detection and fire extinguishing devices, had not been successful, but had suffered

substantial deficits. The debentures in question were of a total issue of $125,000 of 6% secured debentures issued in 1931 to mature in ten years. They were secured under an agreement with Empire Trust Company, a New York corporation, by letters patent then held or which might subsequently be acquired by the Delaware corporation. The Delaware corporation transferred the letters patent as security but continued to hold the right to operate and license others to operate under them. (R. 30–31.)

Continuing unsuccessful and with an increased deficit, the Delaware corporation in 1932 granted an exclusive right to operate under the patents to Garrison Fire Detecting System, Inc., a New York corporation. The taxpayer invested over $26,000 in stock of Garrison of New York in 1932 and 1933. (R. 31.) In October, 1933, another company, Garrison Engineering Corporation, was incorporated under New York law to operate under a license from the Delaware corporation and the taxpayer advanced funds for this company (R. 32).

The Delaware corporation enjoyed but little better success after the granting of the license agreements than it had before, and sustained substantial operating losses in 1933, 1934, and 1935. In 1935 a third corporation, Garrison Engineering Corporation, was organized under Massachusetts law to operate under a license from the Delaware corporation. From October 27, 1935, to January 14,

1936, the taxpayer invested $45,000 in its stock, and from January, 1936, to July, 1936, he loaned the company upwards of $25,000. (R. 32–33.)

Each of the licensee companies was obligated to make royalty payments to the Delaware corporation, some part of which was to be used to satisfy the Delaware corporation's obligations under the debenture agreement (R. 32, 33). After the early part of 1934 the Delaware corporation received no royalty payments from any of its licensees. The Massachusetts corporation was liquidated in 1938 because of disagreement concerning its management. It was the last of the corporations to operate under license from the Delaware corporation. In his income tax return for 1936 the taxpayer deducted from gross income $45,000, representing his investment in stock of the Massachusetts corporation, as having become worthless in 1936. (R. 33.)

In February, 1933, the taxpayer purchased an additional $1,000 of the debentures of the Delaware corporation at a cost to him of $400. In January, 1935, he assumed and paid its indebtedness of $2,500, in consideration of the company's agreement to issue to him a further $3,000 face amount of its debentures. These last debentures were never issued. (R. 32.)

On May 4, 1936, the Delaware corporation caused to be filed its petition for reorganization under Section 77B of the Bankruptcy Act. In

Schedule A, attached to the petition, the assets, consisting solely of its patents, patent rights and good will, were valued at $255,972.89. Describing the financial condition of the corporation the petition stated: "No cash or securities of any nature in possession; there is outstanding a contract with Garrison Engineering Corporation (Mass.) the value of which is uncertain." On September 17, 1936, the taxpayer filed answer and objections to the petition for reorganization in which he asserted that the assets listed in the petition were "grossly over valued," that the debtor was "hopelessly insolvent," and requested reference to a special master to determine the question of solvency. On November 6, 1936, the vice-president and secretary of the Delaware corporation filed an affidavit and a certified copy of a resolution of the board of directors adopted on November 2, 1936. The general purport of the two documents was that the board had concluded that the assets of the corporation had been given an excessive valuation in the petition; that upon consideration it had determined that their fair market value was not more than $10,000; and that it would be to the best interest of the corporation to be liquidated and dissolved. On November 6, 1936, the court, reciting the taxpayer's consent, ordered that the corporation be liquidated. Subsequently, the taxpayer filed proof of claim of an aggregate sum of $106,351.80, representing the face amount

of the debentures issued to him and of those not issued but to which he was entitled, and unpaid interest thereon. (R. 33–34.)

On April 15, 1937, the bankruptcy referee offered the patents and patent applications for sale. The representative of some of the debenture holders, of whom the taxpayer was one, was the sole bidder. Acceptance of his offer of $100 being recommended by the bankruptcy trustee, the referee ordered sale and the same was consummated on April 17, 1937. The proceeds were insufficient to pay the expenses of the proceedings. (R. 35.)

At some time subsequent to the bankruptcy sale, the taxpayer was advised by his attorney that the debentures should be treated as having become worthless in 1937, and that deduction of their cost should be made from his gross income for that year. On December 31, 1937, at the taxpayer's direction his confidential bookkeeper and accountant set up an account for the debentures and made the appropriate entries charging them off as worthless. (R. 35.)

No interest on the debentures was ever paid to the taxpayer, although scrip in lieu of some of the interest payments had been issued to and received by him (R. 35).

The taxpayer reported his gross income for 1936 as $103,477.89, against which he claimed deductions aggregating $53,322.03. His 1937 return showed gross income of $116,684.58. Total deduc-

tions were claimed in the sum of $87,592.12, of which $76,900 was the cost of the debentures, the charge-off of which is here in issue. (R. 35.)

The Tax Court concluded that the taxpayer had failed to show that he ascertained the debentures to be worthless in 1937 (R. 36–37). The Circuit Court of Appeals, *per curiam*, affirmed the Tax Court's decision (R. 185–187).

ARGUMENT

The decision below is squarely ruled by the prior circuit court of appeals decisions which the taxpayer asserts to be conflicting. (Br. 5–6.) To be entitled to a deduction the taxpayer must prove that he ascertained in the tax year that the debt was worthless. As the cases cited by the taxpayer hold, he may validly have ascertained the debt to be worthless in the tax year even though the debt in fact had become worthless in an earlier year, and even though a "reasonably prudent person" would have so ascertained. But if the debt was not in fact worthless in the tax year, the taxpayer could not have ascertained its worthlessness in the tax year. Accordingly, to sustain his deduction he must prove both that the debt was in fact worthless in the tax year and that he then so ascertained. *San Joaquin Brick Co.* v. *Commissioner*, 130 F. (2d) 220 (C. C. A. 9); *Rosenthal* v. *Helvering*, 124 F. (2d) 474 (C. C. A. 2); *Mayer Tank Mfg. Co.* v. *Commissioner*, 126 F. (2d) 588

(C. C. A. 2); *Harris* v. *Commissioner*, 140 F. (2d) 809 (C. C. A. 2).

There is no indication in the opinion of the Circuit Court of Appeals that it discarded the so-called subjective test as defined in those decisions and substituted an objective test, i. e., a test as to when a reasonably prudent man would have ascertained the debentures to be worthless. The Circuit Court of Appeals affirmed the decision of the Tax Court that the taxpayer failed to prove his ascertainment in 1937 that the debentures were worthless (R. 186–187). The taxpayer relied primarily on the fact that the patents securing the debentures were sold on April 17, 1937, for $100. However, there was no showing that there had been any change in their value since 1936. The Tax Court concluded that the debentures were in fact worthless in 1936, and that the taxpayer was not shown to have thought them to have any value after 1936 (R. 36–37). Moreover, the sale of the patents for $100 was not free and clear, but subject to the lien of the debentures which, so far as the record shows, remained outstanding. Hence, without impugning the correctness of the Tax Court's reasoning the Circuit Court of Appeals held that the taxpayer could not prevail even upon his version of the facts as urged in that court. Accepting the taxpayer's premise that the debentures had some remnant of worth at the beginning of the tax year which justified

his continued hope of salvage, the record fails to show that this worth was extinct when the tax year closed. The sale subject to the lien did not demonstrate its extinction. At the time of the hearing in 1942 the company which bought the patents subject to the lien was still selling the same products formerly made under the patents, and sales of apparatus went on through 1937 (R. 57–58). Thus the taxpayer has failed to prove either that the debentures were worthless in fact or that he ascertained their worthlessness in the tax year.

The decision below correctly affirmed the decision of the Tax Court upon a question which is wholly one of fact. Moreover, any question relating to the ascertainment of worthlessness of a debt is rendered unimportant by Section 124 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798 (26 U. S. C. 1940 ed., Supp. III, Sec. 23 (k)). Section 124 (a) amends Section 23 (k) of the Internal Revenue Code to provide retroactively to all years beginning after December 31, 1938, that there shall be allowed as a deduction "Debts which become worthless within the taxable year".

The second point urged by the taxpayer (Br. 7) relates to the Tax Court's exclusion of evidence purporting to show that the Commissioner allowed a bad debt deduction in 1937 to another holder of the debentures (R. 65–66). The evidence was properly excluded as irrelevant (cf. *Seeley* v. *Helvering*, 77 F. (2d) 323 (C. C. A. 2)), and its exclusion plainly raises no question for certiorari.

CONCLUSION

The petition should be denied.

Respectfully submitted.

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AUGUST 1944.

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Argument.

The respondent Commissioner's brief in opposition clearly demonstrates the weakness of his position.

The Commissioner has never made a finding that the Debentures became or were worthless in 1936 or that the taxpayer ascertained them to be worthless in 1936. All the Commissioner originally determined was that no deduction was allowable for the taxable year 1937 on account of the worthlessness of the Debentures (R. 11).

The Tax Court in its opinion, however, decided that it was the taxpayer's burden to show erroneous the Commissioner's nonexistent determination that the taxpayer ascertained the worthlessness in 1936 and further the Tax Court decided that the Debentures were worthless in 1936 (R. 37).

The Circuit Court of Appeals held this part of the decision to be *dicta* (R. 188).

The Circuit Court further decided that the Debentures had not become worthless in 1936 and likewise decided that the taxpayer had not ascertained them to be worthless in 1936 (R. 187).

The whole issue as stated by the Circuit Court is whether or not there was competent evidence to show that the worthlessness of the debt was made certain in 1937 (R. 186).

The meaning of "ascertainment" is discussed in *Quinn* v. *Commissioner*, 111 F. (2d) 372 (C. C. A. 5), where in connection with the deductibility of bad debts it is stated at page 373:

> "The word ascertain means to make certain; to find out or learn for a certainty; to free from obscurity or doubt. Hence, to justify a deduction, the taxpayer must have made a reasonable investigation of the facts and have drawn a reasonable inference that the debt was in fact worthless from the information thus obtained."

On that question, the only evidence in the record is: (1) The petition in bankruptcy (R. 146-7) containing a balance sheet as of April 30, 1936, showing assets of about $255,000 and liabilities of some $177,000, which does not indicate worthlessness; (2) the Answer of this taxpayer, filed September 14, 1936, under oath, stating that he believed the above valuation was grossly excessive and that the debtor was hopelessly insolvent, which however did not determine the worthlessness as the Circuit Court held (R. 186), particularly as in the Answer, this taxpayer (R. 172) asserted that he had unsuccessfully tried to obtain access to the corporate books and records to ascertain whether the bal-

ance sheet of the debtor, attached to the petition in bankruptcy, was correct, and that suggested that he, at least, had not then (September 14, 1936) been able to make certain of the worthlessness; (3) the order of the Court, September 16, 1936 (R. 153) referring the matter to a special Master to hear evidence to determine whether the debtor is insolvent, was not an ascertainment, since that order was vacated in November, 1936 (R. 154); (4) the affidavit of Kaul (R. 176) stating that the value of the assets did not exceed $10,000 and that the liabilities were $177,000, if assumed to be competent, was not such an ascertainment at that time (November 2, 1936) since, except for the sum of about $3,700, the liabilities were all to the debenture holders of which this taxpayer had a 3/5 interest so that his proportionate share of the assets would amount to some $3,800; (5) the petition for sale of the assets (R. 159), their value "*being unknown*", filed April 2, 1937, did not make certain of their worthlessness; (6) and finally on April 17, 1937, the assets were sold for an amount insufficient to pay the expenses of the proceeding (R. 35) and it was then for the first time made *certain* that the debt was worthless.

There is no evidence whatever that in 1936 anybody had made certain of the worthlessness. It is obvious from the evidence that no one could have ascertained the debt to be worthless before April 15, 1937. The value of the patents were absolutely unknown until then. Worthlessness of a debt must be distinguished from insolvency of the debtor which does not mean any more than his liabilities exceed his assets so that the creditors must take something less than 100% of his debt. To be worthless there must be no assets or substantially none and this must be made *certain*. Accordingly if, under the evidence in this case, the tax-

payer had charged off the debt in 1936 and claimed it to be then worthless, and it developed, as it has done here, that worthlessness was not made certain until April, 1937, the taxpayer could not then switch to 1937 because he had already charged off the debt in 1936 and could not charge it off again. The statute required that the charge off be made during the same year that it is made certain that the debt is worthless. This taxpayer, therefore, did the only safe thing, that is, he waited until it was made certain that the debt was worthless.

The suggestion of the Court that he may have had some motive for postponing the ascertainment lacks merit. One cannot possibly make certain of a thing before it becomes certain. In addition the taxpayer would not have been without benefit in claiming the loss in 1936 since the deduction he did take then still left some $53,000 of net income which he could have wiped out if he dared take the chance of having the Commissioner and/or the Court finally determine that worthlessness was not made certain until 1937.

On the other hand, it has been proved without contradiction that in 1937 after said sale the taxpayer consulted with his attorney who advised that the Debentures should be treated as having become worthless in 1937 and that their cost should be deducted from taxpayer's 1937 gross income. In 1937 the taxpayer's bookkeeper, upon taxpayer's instructions, made the appropriate entries so charging them off as worthless (R. 35).

The taxpayer's testimony is likewise uncontradicted that he ascertained the Debentures to be worthless in 1937 after the sale of the patent interests was completed (R. 53).

Even if the patent interests may still have had some value throughout 1937, it does not follow that the Debentures did not therefore become valueless in 1937. This

is not a case of partial deduction (R. 187) but one where the debtor Delaware corporation lost in 1937 all its right, title and interest in its sole remaining assets by the 1937 bankruptcy sale. The Delaware corporation then became lifeless and its obligations, including the Debentures, at the same time became wholly worthless. If the taxpayer in the future should ever realize anything by virtue of the so-called lien of the Debentures, such amount would presumably be includible in his gross taxable income.

That taxing laws are to be construed strongly against the government and in favor of the taxpayer is axiomatic. *Gould* v. *Gould*, 245 U. S. 151, 153.

The Commissioner's statement (Br. 9) that the amendment provided by the 1942 Revenue Act renders unimportant any question relating to ascertainment of worthlessness is not persuasive. The petition herein involves a tax liability of $32,733.96 (R. 30). In addition the 1942 amendment was itself further amended by Section 504 of the Revenue Act of 1943 to apply to all taxable years beginning after December 31, 1937. Accordingly the question of when ascertainment occurred is still of considerable importance as to all years prior to 1938.

The 1942 and 1943 amendments therefore are not a clarification of an old purpose but are a declaration of a new one, leaving the old purpose still in doubt, so much so that the 1943 amendment was deemed necessary for all future years after 1937.

It was never the purpose of Congress either to deny such a deduction or to require a taxpayer to guess when to take it. The above amendments eliminating the charge off and the doubtful word "ascertained" substantiates this.

Conclusion.

The petition should be granted.

Respectfully submitted,

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